

Message Text

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TO SECSTATE WASHDC 5995

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USMISSION OECD PARIS

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C O N F I D E N T I A L SECTION 01 OF 02 BONN 17120

LIMDIS

PASS TREASURY FOR UNDER SECRETARY BENNETT, ASSISTANT
SECRETARY COOPER AND L. WIDMAN

E.O. 11652: GDS

TAGS: EFIN, GW

SUBJECT: GERMAN BUNDESBANK VIEW ON GERMAN ECONOMIC
PROSPECTS AND MONETARY POLICY

1. SUMMARY. DURING A RECENT VISIT THE FINANCIAL
ATTACHE GENERALLY FOUND BUNDESBANK OFFICIALS REDUCING
FURTHER THEIR PROJECTIONS FOR GERMAN ECONOMIC GROWTH
IN 1975. BUNDESBANK OFFICIALS FEEL, HOWEVER, THAT PRICE
PRESSURES ARE STILL SUCH THAT NO OFFSETTING POLICY
MEASURES ARE APPROPRIATE. THEY FORESEE GERMAN CURRENT
ACCOUNT AND NET FOREIGN BALANCE SURPLUSES IN 1975 ONLY
SLIGHTLY BELOW THE 1974 RECORDS. PLEASE FULLY PROTECT
THESE INFORMAL VIEWS. END SUMMARY.

2. DURING RECENT SEPARATE CONVERSATIONS WITH THE
FINANCIAL ATTACHE BOTH BUNDESBANK VICE PRESIDENT
EMMINGER AND BOARD MEMBER SCHLESINGER (IN CHARGE OF
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RESEARCH) INDICATED THAT THEY SAW LITTLE CHANCE FOR

ANY REAL GROWTH IN GERMAN GNP DURING THE FIRST HALF OF 1975 (OVER THE SECOND HALF OF 1974, SEASONALLY ADJUSTED). THEY SAW NO SIGNS FOR ANY SIGNIFICANT PICK-UP IN INVESTMENT AND FELT THAT INCREASED GOVERNMENT DEFICITS AND CONSUMER SPENDING ARE NOT LIKELY TO HAVE A SIGNIFICANT IMPACT UNTIL LATER ON IN 1975. THEY FELT THAT IT REMAINS TO BE SEEN WHETHER IF PRIVATE SPENDING PICKS UP, THIS WILL BE ABLE TO INDUCE AN INCREASE IN INVESTMENT SPENDING DURING THE SECOND HALF OF 1975. SCHLESINGER FELT THAT GERMAN EXPORTS DURING 1975 MIGHT BE MAINTAINED IN REAL TERMS AT APPROXIMATELY THE 1974 LEVEL WHILE REAL IMPORTS MIGHT INCREASE SOMEWHAT AND THE NET FOREIGN BALANCE FOR 1975 DECLINE SLIGHTLY BELOW THAT FOR 1974. (COMMENT: THIS CONTRASTS WITH THE GERMAN ECONOMIC RESEARCH INSTITUTES WHICH FORECAST AN INCREASES IN 1975.) EMMINGER IMPLIED THAT HE SAW A SOMEWHAT GREATER DECLINE IN GERMANY'S NET FOREIGN BALANCE, BUT AGREED THAT HIS EARLIER PREDICTION OF A GERMAN CURRENT ACCOUNT DEFICIT FOR 1975 NO LONGER SEEMED REALISTIC AND THAT HE NOW THOUGHT THAT THE 1975 GERMAN CURRENT ACCOUNT SURPLUS WOULD STILL BE QUITE SUBSTANTIAL. (COMMENT: IN COMMENTING ON THE RELATIVE FAVORABLE PROSPECTS FOR GERMAN EXPORTS DURING 1975, EMMINGER STRESSED INCREASED EXPORTS TO THE ARABS AND THE EAST. SCHLESINGER COMMENTED THAT GERMAN BALANCE OF PAYMENTS AID WAS LIKELY TO PREVENT TOO SHARP IMPORT RESTRICTIONS BY SOME OF THE MAJOR TRADING PARTNERS.) BOTH EMMINGER AND SCHLESINGER THOUGHT THAT FOR 1975 AS A WHOLE REAL GNP MIGHT GROW BY ABOUT 2 PERCENT OVER 1974 AND THE PRICE PERFORMANCE WOULD BE VERY SLIGHTLY BETTER THAN IN 1974.

3. IN RESPONSE TO QUESTIONS WHETHER THIS MUCH LOWER GROWTH THAN HAD BEEN EXPECTED EVEN A FEW MONTHS AGO (AND THE CONSEQUENT LIKELIHOOD OF HIGHER UNEMPLOYMENT AND TRADE SURPLUSES THAN PREVIOUSLY PROJECTED) WOULD NOT AND SHOULD NOT BRING POLICY CHANGES, EMMINGER AND SCHLESINGER IN EFFECT BOTH REPLIED IN THE NEGATIVE. BOTH FELT THAT THE PUBLIC BUDGET DEFICITS (ROUGHLY DM 40 BILLION) ALREADY PLANNED AND IMPLICIT IN THE CONFIDENTIAL

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ABOVE PROJECTIONS WERE SO LARGE THAT NO SIGNIFICANT FURTHER INCREASES COULD BE CONTEMPLATED BY THE PUBLIC AUTHORITIES. OTHERWISE THEY WOULD MANEUVER THEMSELVES INTO AN UNTENABLE POSITION IN 1976 WITH AN IMPOSSIBLY LARGE GAP BETWEEN RECEIPTS AND EXPENDITURES DURING THAT YEAR (WHICH THEN WOULD BE CLEARLY INFLATIONARY AND BECAUSE OF THE FEDERAL ELECTION WOULD BE PARTICULARLY DIFFICULT TO CLOSE EITHER BY REDUCING

EXPENDITURES OR INCREASING TAXES). AS FAR AS MONETARY POLICY WAS CONCERNED EMMINGER SAID THAT HE FELT THAT THERE WAS VERY LITTLE ROOM TO MANEUVER WITHOUT LOSING THE PROGRESS MADE IN THE FIGHT AGAINST INFLATION.

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C O N F I D E N T I A L SECTION 02 OF 02 BONN 17120

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SCHLESINGER AGREED AND SAID IT WAS REALLY ONLY A QUESTION OF KEEPING THE EXPANSION OF CENTRAL BANK MONEY MADE AVAILABLE TO THE ECONOMY AT AN ANNUAL RATE OF 6, 7 OR AT MOST 8 PERCENT. MORE WAS NOT POSSIBLE WITHOUT LOSING GROUND IN THE FIGHT AGAINST INFLATION AND EVEN AT AN 8 PERCENT ANNUAL INCREASE, THE ECONOMIC PICTURE OUTLINED IN PARA 2 ABOVE WOULD NOT CHANGE VERY SIGNIFICANTLY.

4. CONCERNING THE RECENT REDUCTION IN THE GERMAN DISCOUNT RATE, ALL BUNDESBANK BOARD MEMBERS TO WHOM THE FINANCIAL ATTACHE TALKED STRESSED THAT IT WAS MAINLY INTENDED TO SIGNAL TO THE BOND MARKET THAT THE CENTRAL BANK FELT INTEREST RATES SHOULD NOT RISE ANY FURTHER AND GRADUALLY START TO COME DOWN. THERE WAS,

HOWEVER, LITTLE IMPLEMENTING ACTION SO FAR TO INCREASE
BANK LIQUIDITY ENOUGH TO BRING THIS ABOUT. THE
DECISION WAS A VERY CONTROVERSIAL ONE AND PASSED AT
THE INSISTENCE OF PRESIDENT KLASSEN BY A MAJORITY OF
ONLY ONE VOTE. (ESSENTIAL YOU PROTECT THIS.) AMONG
FRANKFURT COMMERCIAL BANKERS TO WHOM THE
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FINANCIAL ATTACHE TALKED, THERE IS SOME BITTERNESS
OVER THE DECISION SINCE A SUBSTANTIAL PORTION OF THEIR
OUTSTANDING LOANS IS STILL TIED TO THE DISCOUNT RATE
AND CONSEQUENTLY THEIR PROFITS ARE SQUEEZED WHEN THAT
RATE IS REDUCED WITHOUT AT THE SAME TIME INCREASING
THEIR LIQUIDITY SUFFICIENTLY. THE ACCOMPANYING
REDUCTION IN THE LOMBARD RATE AND REDISCOUNT QUOTAS
ON THE OTHER HAND ARE GENERALLY WELCOMED AND THE
BANKING COMMUNITY IS HOPING THAT THE BUNDESBANK WILL
SOON FOLLOW ITS REDISCOUNT RATE "SIGNAL" WITH FURTHER
ACTION TO EASE BANK LIQUIDITY.
HILLENBRAND

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